R5650-2

JAPAN · ECONOMIC · INSTITUTE

JEI REPORT

NO. 19B
May 16, 1986

IN THIS ISSUE:

Sour Taste Lingers From Summit 1

Can Implementation Guidelines Fend Off Maekawa Report Foes? 3

Appreciating Yen Reaches Y160 Level 4

DOD Burdensharing Report: "Significant Steps" 5

Update On Japan's Telecommunications Market 8

Punitive Provisions Mark Trade Reform Bill 10

Notes 12

Sour Taste Lingers From Summit

Perceptions that Prime Minister Yasuhiro Nakasone failed to effectively represent Japanese interests in the recent economic summit linger in Japan, complicating the incumbent's hope of remaining in office beyond October 1986 as president of the Liberal Democratic Party. Although criticism has not been universal, several major dailies have expressed disappointment with the results of the seven-nation meeting, particularly the explicit reference to Libya and the failure to secure a commitment to stabilize the yen's value.

In some respects, Mr. Nakasone may have been a victim of the consensus-building process that characterizes Japanese politics. Led by the United States, the declaration on terrorism was included on the summit agenda more rapidly than Japan would have liked. Tokyo press reports suggest that preliminary drafts of the anti-terrorism proclamation did not refer to any specific

finance ministers of the seven nations to meet periodically to assess their economies, based on 10 indicators: economic growth rates, inflation rates, interest rates, unemployment rates, budget deficits, current account and trade balances, monetary growth rates, reserves and exchange rates. It will then be up to the finance ministers to decide on appropriate measures, including intervention in exchange markets, whenever there are significant deviations from the projected course.

While most economists praised the plan as a constructive step toward more stable exchange rates, it is not clear that the proposal can be effectively implemented. With no enforcement mechanism save peer pressure and the force of public opinion, it is an open question whether or not the agreement will produce more consistent economic policies. C. Fred Bergsten, director of the Institute for International Economics, called the plan an "impressive step forward," but said it would "need an independent referee to blow the whistle."

Economists also praised the plan for focusing on the economic fundamentals that determine exchange rates rather than on intervention. Although intervention was successful last fall because it was consistent with market trends, it is unlikely to reverse the direction of a market that trades $150 billion a day. For example, intervention by the Bank of Japan, estimated at about $300 million on May 8, was unable to slow the currency's rise.

Responding to alarm over the pace of the yen's appreciation, Prime Minister Yasuhiro Nakasone renewed his call May 9 for coordinated intervention to stablize its value. A report that the central banks of Japan and West Germany had agreed to a joint effort to slow the dollar's fall was denied, indicating that Japan stands alone in its effort to stop the dollar's plunge. Finance Minister Noboru Takeshita told the Diet that he wants an early meeting of the Group of Five finance ministers to discuss exchange rates.

The sharp appreciation of the yen to the Y160 level has made an exchange rate of Y150=$1.00 before summer a real possibility, according to some market analysts. The Nihon Keizai Shimbun econometric model predicts that the rise of the yen from the Y165 level to Y150 will lower inflation-adjusted growth in FY 1986 from 2.3 percent to 1.5 percent, while reducing the increase in the consumer price index from 1 percent to 0.4 percent.

Randall S. Jones

DOD Burdensharing Report: "Significant Steps"

The Department of Defense's annual "Report on Allied Contributions to the Common Security" concludes that Japan's present defense funding levels -- if continued -- will result in "significant steps" toward improved security in the Pacific. In a far more detailed report than it had produced in recent years, DOD said that Tokyo's steps to enhance its defense capabilities, including coverage of the sealanes approaching Japan, were generally in the right direction.

The report notes that the first year of Japan's current five-year defense plan has been sufficiently funded to achieve its stated goals. All major frontline procurement requests were met and spending on sustainable items

Total Active Duty Military Manpower

(in thousands)

Country	1971 Number	1971 Percent of NATO/Japan Total	1971 Rank	1984 Number	1984 Percent of NATO/Japan Total	1984 Rank	Percent Change 1971-84
United States	2,714.0	42.9%	1	2,222.0	35.1%	1	-18.1%
Turkey	614.5	9.7	2	814.5	12.9	2	32.5
France	569.3	9.0	3	570.5	9.0	3	0.2
Italy	526.0	8.3	4	507.7	8.0	4	-3.5
Spain	---	---	-	491.3	7.8	5	n.a.
West Germany	472.0	7.5	5	487.5	7.7	6	3.3
United Kingdom	384.0	6.1	6	336.3	5.3	7	-12.4
Japan	234.3	3.7	8	241.0	3.8	8	2.9
Greece	178.7	2.8	9	197.1	3.1	9	10.3
Belgium	106.8	1.7	11	107.1	1.7	10	0.3
Netherlands	113.0	1.8	10	103.3	1.6	11	-8.6
Portugal	244.2	3.9	7	100.3	1.6	12	-58.9
Canada	86.9	1.4	12	82.0	1.3	13	-5.6
Norway	36.3	0.6	14	39.5	0.6	14	8.8
Denmark	44.5	0.7	13	30.8	0.5	15	-30.7
Luxembourg	1.1	0.0	15	1.2	0.0	16	11.8
Non-US NATO	3,377.3	53.4		3,869.1	61.1		14.6
Non-US NATO + Japan	3,611.6	57.1		4,110.1	64.9		13.8
Total NATO	6,091.3	96.3		6,091.1	96.2		0.0
Total NATO + Japan	6,325.6	100.0		6,332.1	100.0		0.1

Source: Department of Defense, Report on Allied Contributions to the Common Defense: A Report to United States Congress, March 1986.

Total Defense Spending as Percent of GDP, 1971 and 1984

Country	1971 Percent	1971 Rank	1984 Percent	1984 Rank	Percent Change 1971-84
Greece	4.7%	4	7.2%	1	53.8%
United States	7.1	2	6.5	2	-7.6
United Kingdom	4.9	3	5.3	3	8.0
Turkey	4.5	5	4.4	4	-3.1
France	4.0	6	4.1	5	3.2
West Germany	3.4	9	3.3	6	-2.6
Portugal	7.4	1	3.3	7	-56.0
Netherlands	3.4	7	3.2	8	-6.2
Belgium	2.9	10	3.2	9	11.2
Spain	--	--	2.9	10	n.a
Norway	3.4	8	2.8	11	-16.3
Italy	2.7	11	2.7	12	-0.7
Denmark	2.4	12	2.3	13	-5.0
Canada	2.2	13	2.2	14	-3.1
Luxembourg	0.8	15	1.2	15	50.0
Japan	0.8	14	1.0	16	20.4
Non-US NATO	3.6		3.5		-0.5
Non-US NATO and Japan	3.0		2.8		-6.1
Total NATO	5.5		5.2		-5.0
Total NATO and Japan	5.0		4.6		-8.4

Naval Force Tonnage* and Tactical Air Combat Aircraft, 1984

Country	Naval Forces Percent of NATO/Japan Total	Naval Forces Rank	Aircraft Percent of NATO/Japan Total	Aircraft Rank
United States	63.69%	1	41.30%	1
United Kingdom	10.85	2	9.21	3
France	4.88	3	9.29	2
Spain	3.29	4	1.87	6
West Germany	3.17	5	8.73	4
Japan	3.13	6	4.12	7
Spain	2.19	7	1.87	12
Italy	1.77	8	5.86	5
Canada	1.79	9	2.39	10
Greece	1.77	10	4.01	8
Netherlands	1.42	11	2.29	11
Portugal	0.63	12	1.13	15
Norway	0.62	13	1.47	13
Denmark	0.43	14	1.38	14
Belgium	0.29	15	2.51	9
Luxembourg	0.00	16	0.00	16
Non-US NATO	33.18		55.58	
NON-US NATO + Japan	36.31		58.70	
Total NATO	96.87		95.88	
Total NATO + Japan	100.00		100.00	

*Not including strategic submarines.

was also raised for fiscal 1986 (April 1, 1986-March 31, 1987). The report implies that the one percent of GNP spending limit will be broken during the course of the five years since Japanese government officials have given the acquisition goals of the plan higher priority than the one-percent limit. Ammunition outlays were increased by 13.8 percent over FY 1985, an area that is of considerable concern to DOD officials because of existing deficiencies.

While the report reiterates previous years' remarks that Japan "ranks close to last or last on most performance measures compared to ability to contribute," the document goes on to note that "Japan recognizes this obligation and has the second highest percentage change in defense spending from 1971-1984." It adds that the Nakasone cabinet has continuously given high priority to defense in its budgets.

In accordance with the 1985 Byrd amendment, the 1986 burdensharing report specifically analyzes Japan's progress toward meeting the goal of defending the sealanes to a distance of 1,000 nautical miles. The DOD study concludes that measures now in implementation or under study, "if continued on the route to full funding, [represent] the necessary minimum to meet Japan's defense goals, including defense of the sealanes to 1,000 miles." While emphasizing that future adjustments may be necessary to meet changes in the security situation, "Japan's 1986-1990 program does represent an appropriate, significant step forward in achieving Japan's defense goals."

While these observations may not be what congressional critics of Japan's defense policies hoped for when they overwhelmingly approved the Bryd amendment, the report nevertheless keeps defense issues active and in that sense results in continued pressure on Japan to maintain at least the present pace in improving its defense capabilities. The overall tone of the report is balanced and defenders of Japanese policies can find more than enough evidence in it to justify their positions. In fact, the report is almost upbeat in its assessments of Japanese capabilities.

Michael W. Chinworth

Update On Japan's Telecommunications Market

One year after liberalization, Japan's telecommunications market is humming with activity. While many domestic and foreign companies are making good progress, others have stumbled. In addition, deregulation fever has spread to the international communications area, even though the original legislation did not explicitly include it. While many U.S. officials are willing to give Tokyo a chance to prove that American firms will be treated fairly in Japan's deregulated market, a House committee has nonetheless approved legislation implementing tough reciprocity guidelines for telecommunications equipment. As expected, Tokyo's response to the bill has been negative.

The Type I, or common carrier, market is proving to be fertile ground for foreign companies, even though they are barred by law from majority ownership of Type I companies. Daini Denden Inc., a consortium of firms building a microwave network in the Tokyo-Kyoto corridor, will use equipment produced by